

The Free Market

"If you don't create a free market, a black market will emerge"



NEWSLETTER OF THE LITHUANIAN FREE MARKET INSTITUTE

2006 NO. 1 (FEBRUARY – MARCH 2006)

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NEWS

› LFMI's writing contest "Freedom Studies"

In pursuit of its educational activities, LFMI has announced a writing contest "Freedom Studies," aimed at enhancing the understanding of social and economic laws in the life of the society.

Drawing on the experience of the previous two contests, LFMI invites studying people to get acquainted more closely with the works of free-market philosophers. In 2006 the LFMI's contest marks the 125th birth anniversary of Ludwig von Mises who is among the world's most prominent economists of the 20th century. Contestants are asked to analyse Mises' works - *Liberty and Property, Capitalism, Socialism, Interventionism, Inflation, Foreign Investment, Politics and Ideas*, and *Bureaucracy* - and to write an essay which would be based on, or debate/develop/apply, the ideas reflected in one or several of these writings. All of these works by Mises have been published in Lithuanian and are posted on LFMI's website.

The contest is designed for university students and self-studying people who are above 17 years of age and do not hold a PhD. LFMI believes that by writing this essay, students will be encouraged to analyse how economic and social laws function in the society, to understand peoples' motives in social-economic activities, and to perceive that the variety of people's aims and values

does not disturb but, to the contrary, maintains a smooth coexistence of the society.

The winners of the contest will be announced in September 2006 and will be awarded by cash prizes. The best papers will be posted on LFMI's website in Lithuanian. LFMI hopes that this contest will develop a tradition of teaching freedom as a subject that requires profound public understanding.

› LFMI's position on furthering the tax reform in Lithuania

On 28 February 2006 LFMI staged a press conference and a round table discussion "It's Time to Speed Up the Tax Reform in Lithuania" and presented a package of policy proposals on urgent changes in the Lithuanian tax system. The Institute's recommendations have been designed with a view to reducing emigration of the labour force, increasing Lithuania's competitiveness and enhancing people's welfare.

LFMI's proposals embrace a number of taxes applied in Lithuania. According to LFMI, it is indispensable to cut the personal income tax without delay (from the current 33-percent tax rate to 24 percent starting from 2007 and to 15 percent from the beginning of 2009), to set an upper ceiling on state social insurance contributions (of 3.5 average wage) and to gradually increase the component of the social insurance contribution allowed to be transferred to private pension funds, and to abolish the newly imposed real estate tax for residents applied to real estate used for commercial purposes, the new social tax for companies and all exemptions of the value added tax.

Although participants expressed various views regarding the specific details of the tax reform, the majority agreed that the personal income tax needs to be lowered considerably and urgently and that the ceiling on social insurance contributions needs to be established before long. There was also unanimous agreement among the discussants that tax exemptions distort the market and complicate tax administration.

LFMI hopes that the proposed package of tax policy solutions will serve as the first practical step towards

shaping a plan for a real and tangible tax reform in Lithuania.

› **LFMI signs a petition on EU energy policy**

Seeking to promote competition in the EU energy policy, in March 2006 the Lithuanian Free Market Institute (LFMI) joined a group of European think-tanks and signed a petition on EU energy policy initiated by the Instituto Bruno Leoni (Torino, Italy), in cooperation with other two organisations Instituto Juan De Mariana (Madrid, Spain) and Liberalni Institut (Prague, Czech Republic). The petition was signed by around 90 individuals and organisations and submitted to the European Commission and national governments.

The petition came as a reaction to the French government's decision to sanction the merger of Gaz de France and Suez to prevent the bid of the Italian company Enel, as well as the opposition of the Spanish government to the acquisition of Endesa by the German group E.ON, which are not unusual episodes.

The petition says that despite the weakness of the European Union's energy policy, member states are trying to lock domestic markets, with the goal of shielding companies they control or that they are otherwise linked to. "Not only is this practice shattering the dream of an economically integrated Europe, it is also very likely it will have an awfully adverse impact on the consumers,"- believe the signatories.

According to the petition, opinion leaders, decision-makers and the public at large ought to be aware of the near-sightedness of the current policies, which threaten the competitiveness of European companies and the stability of the economy for the sake of a potential short-term advantage.

The organisations urge the European Commission and national governments to commit to the following concrete measures: to remove the barriers to the consolidation of European companies, by abstaining from hindering any acquisition of national companies by foreign enterprises; to sell majority stakes of energy companies, where they are government-owned; and to open all domestic markets in order to promote the development of a genuine European internal market.

"Only these measures will render Europe able to deploy on the global markets strong actors able to compete, to innovate and to succeed,"- believe the signatories.

The full text of the petition can be found at: <http://www.brunoleoni.com/nextpage.aspx?codice=0000001245>.

› **LFMI comments on the copyright levy**

Pursuing activities in one its strategic areas – the tax policy, LFMI has analysed the currently debated new bill of the Law on Copyright and Neighbouring Rights and

submitted comments on the proposed new copyright levy, March 2006. It is a tax collected from taxing various medium which can be used for reproducing copyright products and audiovisual equipment with a reproduction function (audio and visual players, film cameras, telephones, copying machines, faxes, etc.). Tax revenues are then distributed among the authors who are harmed through copying of their works.

LFMI concluded that the proposed mechanism of copyright levy will not protect the authors' rights from violation and it will not even deter from violating these rights, which is the specific requirement for this tax set in EU laws. According to LFMI, such method of taxation would serve as legalization of piracy when it becomes legal to reproduce works because the right to do so has already been paid (by taxing equipment), and, *vice versa*, all privately imposed measures against piracy would become legally questionable.

The mechanism of copyright levy proposed in the draft law is disproportionate as it is impossible to calculate precisely who suffers what precise loss, while the harm done is only hypothetical. In addition to that, the proposed tax imposed on products brought into the territory of Lithuania is tantamount to import duties, the measure prohibited in the common market of the EU.

LFMI pointed out that the Directive 2004/48/EB does not require adopting such type of taxation which is put forth in the mentioned draft law. According to EU law, member states themselves choose the way of taxation in case it is in general needed.

LFMI thinks that the alternative to a copyright levy could be the right retained for authors to judge themselves whether to permit or prohibit reproduction of their works. No restrictions should be imposed when authors permit copying of their works, while the law should seriously take into account when authors prohibit reproduction. To protect works from copying, authors should be allowed to apply technical measures intended for their protection.

As it is likely that consumers would disregard the authors' prohibition and circumvent the technical means employed, the law should envisage that a single copy of an author's work, which is prohibited to be reproduced, made for non-commercial purposes is not harmful and should not be penalized.

› **Employees do not prioritize labour laws and would accept a freer employment regulation, a survey shows**

A representative sociological survey conducted by the Lithuanian Free Market Institute (LFMI) and the company RAIT demonstrates that the majority of employed people in Lithuania do not prioritise laws regulating employment and would not object if employment regulation was not as rigid as it is at present.

The survey was aimed at eliciting how employees evaluated relations between employers and employees,

the working time, salaries and other issues of labour, as well as various violations of labour laws.

As the survey results show, the majority of working individuals in Lithuania do not think that employment relations should be characterised as hostile. In other words, employees do not think that labour laws are intended to protect them as a weaker party of employment relations (68.1 percent of respondents).

Nearly half of those polled believe that the source of improvement of their working conditions is development and a better financial situation of companies they work in, rather than government, a stricter regulation or control.

The poll also uncovered that every third employee, both in private and public sector, works overtime which is not paid respectively. Four out of five working individuals would agree to work overtime and receive extra remuneration for such work. LFMI believes that people are sending a clear signal that they do work overtime despite official prohibition. Thus it is necessary to amend the Lithuanian Labour Code and allow working overtime officially – only under such circumstances workers would have opportunities to work extra time legally and to demand official payment for overtime work.

More than half of respondents (59.6 percent) think that regulation of the working time is not very important because the length of their work usually depends on mutual agreement with an employer, notwithstanding that the Labour Code either fixes a certain working time or delegates it to be regulated by collective contracts. This leads to the conclusion that workers do not give much prominence to the power of labour laws, collective or formally concluded labour contracts.

Respondents were also asked to evaluate the activities of trade unions in Lithuania. The results show that only 14.9 percent of working individuals are satisfied with trade unions' representation of their interests. As much as 56.2 percent respondents reported to have negative views regarding trade unions' work: 33.1 percent said trade unions were detached from workers, 13 percent believe trade unions mind the interests of their leaders, and 10.1 percent thought that trade unions were incapable to represent the variety of interests of private individuals.

LFMI is of the opinion that such adverse attitudes towards the activity of trade unions should alarm trade unions in the first place and also the government which has vested wide powers to trade unions to represent the interests of *all* employees in the country (e.g. in the Tripartite Council). Taking into account that workers evaluate the activity of trade unions rather unfavourably, the first thing to do for decision makers is to eliminate the wide powers granted to trade unions to conclude collective contracts on behalf of all workers (even those who are not members of trade unions).

This opinion poll was carried out in 24 November - 3 December 2005 and 1,093 Lithuanian residents of 16 to 74 years of age were polled. The results were presented at a press conference on 15 March 2006.

> Petition on the excise tax policy in the European Union

On 14 February 2006, the Lithuanian Free Market Institute released a petition on the excise tax policy in the European Union signed by sixteen European free-market think tanks. The Petition was submitted to the European Commission, the European Parliament and the Council of Europe as well as national governments of the member states.

The Petition has been prepared in view of adverse effects of high excise taxes on the consumers in the new member states, the ongoing discussions on increases in excise duties and further steps taken towards tax harmonisation. A group of European free-market think tanks have undersigned the petition highlighting the negative effects of EU's excise tax policy and encouraging national governments and EU institutions to consider these implications and to commence discussions on changes in the excise policy.

According to the petition, failures of partial excise harmonisation have revealed inherent flaws of tax harmonisation: societies are prevented from having lower taxes and smaller and more efficient governments; member states have limited opportunities to adapt to their unique social, economic and geographic conditions; and national governments are shielded from potential competition amongst them.

Excise duties constitute up to 80 percent of the price paid by consumers, thus heavily distorting market information about the supply and demand as well as long-term prospects and needs to adapt to changes in the market. The abolition of the minimum level of excise duties and the reduction of excise tariffs are long-term measures in order to help the consumer to adapt to the changes in the market.

The petition says that harmonization of excise duties fails to attain its objectives: differences in prices across EU member states remain considerable, collision of wine-producing countries and the remaining member states demonstrates the narrowness of the goals set for the excise policy, and different tariffs of excise duties among member states are tolerated by the EU itself as they do not distort the competition and the internal market. Minimum levels of excise duties were revised before the last EU enlargement took place; these levels were designed to meet the living and income standards in the EU-15 and proved to be too burdensome for Central and Eastern European countries.

"We believe that it is internal competition and the four freedoms, not uniform taxes, that create the common market,"- the European think tanks reported and urged EU and national authorities to launch an EU-wide debate on the reform of the excise tax policy and considering an abolition of the minimum level of the excise duties.

COMMENTARY

The following commentary has been prepared for the online European magazine 'Cafebabel.com.' The shortened version of the commentary, titled 'Toward a Europe without Borders,' was posted on 17 April 2006. We present the full and original version of LFMI's writing.

Freeing the Movement of Workers Now would be the Only Sound Economic Step

By Giedrius Kadziauskas, Senior Policy Analyst, LFMI

"A policy of freedom for the individual is the only truly progressive policy," said once F. A. Hayek, Nobel Prize winner in economic sciences. Free movement of workers, capital, goods and services is an economically sound policy benefiting individuals and societies the most. Free exchange of goods and services, exploitation of competitive advantages, has already won the debate against protectionism and mercantilism and put the EEC train to reach the common market. Free movement is Europe's choice made 50 years ago – "and one internal market is at the end of the day beneficial for everyone - for every member state and for the consumer and for the business world," reiterated Competition Commissioner Neelie Kroes recently.

The Commission, the guardian of the treaties, has an obligation to push economic integration forward. In its recent assessment of intra Community migration after the enlargement, the Commission concluded that migration has had a positive effect on the EU-15 economies, since it increased the employment in the receiving countries. It also admitted that the EU-10 workers have a complementary role in the labour market and do not burden social security systems of the EU-15. The Commission recommended lifting the barriers: „Be proud and take advantage of the sheer energy, dynamism and hard work that people from the new member states bring," Trade Commissioner Peter Mandelson said.

The Commission's opinion is supported by basic economic logics. Protection of local workers against the competition results in higher prices for goods and services paid to local high-cost service providers and producers. The Polish plumber serves as a successful example of that. Consumers are forced to pay more for services, which could be cheaper otherwise, and could have more money to spend to satisfy other needs. Shielded from foreign competition, service providers have little motivation to improve. Consumers in the UK, Ireland or Sweden are happy with cheaper and higher-quality

construction workers. Illegal migrants suffer from barriers as well. Since they become engaged in illegal, often criminal labour, they cannot use healthcare or social security schemes, and illegal workers have fewer incentives to re-emigrate. Keeping the barriers is protecting a small group of workers against the consumers and other workers – a politically attractive, but economically unsound policy.

Countries unwilling to remove the barriers, for example, Germany or France, admit the problematic situation of their economies and take necessary but unpopular measures, like *Hartz IV* reform in Germany reducing unemployment benefits or the First contract law, currently under fire in France. Both measures aim at boosting employment and growth – they increase labour market flexibility and reduce incentives to remain unemployed. Lifting the restrictions for migrants from the EU-15 goes the same direction, as the Luxembourg's Prime Minister Jean-Claude Juncker put it: "We know exactly what to do, but we do not know how to win the next elections after we have done it." Migrants do not pose threat to structural problems that the countries possess – red-tape difficulties to run a business, high company profit and personal income taxes, unemployment benefits reducing motivation to work, etc. Moreover, Germany, Italy or France, with negligibly growing economies, are not as attractive to migrants, as compared to easier targets – the UK or Ireland.

Barriers to free movement of workers are anachronisms if compared to the advanced free movement of goods. Praise for the free movement of goods, when at the same time promoting superficial threats posed by movement of workers, reveals a short-sighted approach to economic integration. Free movement of goods, especially thanks to the inapprehensive stance of the European Court of Justice, is a cherished but sometimes unnoticed economic reality. It was the Court that paved the way for the free movement of goods in the 70s. As the Commission often remains unheard when advocating to the national governments for a freer flow of workers or services, the hope remains that the Court would look into the letter and spirit of the Treaties and will foster the remaining freedoms with its binding force.

LFMI's Vice-President dr. Remigijus Šimašius analyses the fallacies of the European Social Model. The following commentary was broadcast on the Lithuanian national radio on 29 March 2006.

Labour, Stability, Welfare?

By Dr. Remigijus Šimašius, Vice President, LFMI

Europe is the cradle of Western civilisation which has given birth to institutions that have enabled the prosperity of mankind. These institutions are private property, individual's autonomy and freedom of contract. However, "the European Social Model" as we know it today is far from being even close to these notions. This Model is predicated on a mindset and imagination that certainty of an individual's personal status in the economy (i.e. guaranteed stable employment and income) is compatible with general economic welfare. Under such thinking, private property is valued less and less, and even slogans of freedom, equality and brotherhood are predominantly turning into demands for labour, stability and well-being. What is this – a hope for universal welfare or loosing one's pound for a penny?

So desired certainty implies that it has to be ensured by other members of society, while the necessity for self-made efforts of an individual becomes markedly diminished. The situation when a larger portion of society is "ensured" with income by the few engenders problems with individual initiative and endeavour at producing welfare. If from their early days people know they will certainly get a good job, if they know that when they get this job they will be able to retain it until their retirement age, and if they know that somebody else will pay for their pension - economic stagnation, depression, downturn and, eventually, collapse are bound to come. And it is quite off the point that such a state will be gloriously labelled as a "welfare state." An existing possibility of changes invariably intimidates and impels to self-improvement when creating welfare, that is why the dynamics and flexibility of the market are inevitable attributes of a welfare-producing society.

Paradoxically, what keeps Europe still going today is that stability is guaranteed not to every citizen of the so called "welfare state". In other words, some Europeans create welfare while others utilise it. It is absolutely obvious that justice is highly and reasonably questioned under such conditions. However, consumers of welfare are fierce defenders

of their privileges indeed. For example, an army of British employees of government and municipal institutions, who are entitled to receive retirement pensions from their fellow citizens at an earlier age compared to their counterparts in the private sector, have recently poured in the streets striking. The cause of protests was a proposal to eliminate this privilege.

Despite economic inefficiency and social injustice, the myth of the so-call European Social Model is still alive. Today citizens of its greatest proponent – France – are just about erecting barrages in its defence. This time it all started when the French authorities passed a law aimed at liberalising employment regulation. This piece of legislation significantly loosened firing procedures of people under 26 and being employed for the first time. The French government is definitely correct saying that this measure will help curbing unemployment among young people. It is clear after all that no employer will hire a person being aware that later he will not be able to terminate the contract with this worker... But the current situation in France raises a more glaring question – why liberalisation was only partial?.. This in itself evokes the feeling of injustice and deception. Bearing in mind that during the previous riots in the country accusations were usually pinned not on the rioters but on citizens who had "failed" to properly integrate them into society, it is no wonder that millions are marching in the streets and tens of thousands are devastating window-cases.

Riots have been taking place only in France so far, but demands for pseudo-justice abound in a far bigger number of European countries (including the already mentioned massive revolt of British budgetary workers against the removal of their privileges). It thus poses big danger that the new EU member states, which at present are typically more enthusiastic at introducing the free-market methods and less reliable on government regulation, will follow the same route. For instance, in Slovakia, the most successful EU reformer in recent years, discontented medical workers have already gone out on strike.

In Lithuania, which is currently reaping the fruit of the market-based reforms of the past decade, trade unions also attempt at exacting stability for all. In addition to traditional requirements to raise pensions and social assistance benefits and introduce progressive taxation, they propose to fix by law a formula for indexing wages and salaries even in the private sector. The question of who is going to finance increased benefits seems to be non-existent. Market relations in the labour market also seem to

be unnoticed – as if salaries must climb in line with some magic macroeconomic indicators rather than a particular labour's demand and supply on the market and value added generated. To put it in other words, trade unions suggest measuring the benefits according to some general formulae rather than individual merits made in creating it.

The Lithuanian Government, just as governments in other countries, is set for negotiations. One party (trade unions) will demand for things that don't belong to them, the other party (the government) will decide on what portion to promise of what, again, does not belong to them either. Everyone is talking about the noble goals of social welfare while the creation of welfare itself and those creating it are usually left outside the focus. Negotiators are generally not the ones to propose that attention should be paid to all people, not just the interest groups, and that wishing to distribute at least the same amount as it is at present, conditions for those creating welfare should at least not be aggravated.

The Free Market is a quarterly newsletter of the Lithuanian Free Market Institute, disseminated in electronic form for free.

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The Free Market is published by the Lithuanian Free Market Institute – an independent non-profit organisation established in 1990 to advance the ideas of individual freedom and responsibility, free market and limited government. Our motto is

If you don't create a free market, a black market will emerge

The founders of LFMI are – Prof. Kęstutis Glaveckas, Nijolė Žambaitė, Dainius Pupkevičius, Petras Auštrevičius, Elena Leontjeva and Darius Mockus.

LFMI pursues its mission by conducting research on key economic policy issues, developing conceptual reform packages, submitting policy recommendations at the legislative and executive levels, drafting and evaluating legislation, and launching public campaigns. LFMI's activities also include sociological surveys, publications, conferences, workshops, and lectures.

LFMI receives financial support from individuals, corporations and foundations. Devoted to the principles of private ownership, LFMI accepts no funds from the Lithuanian government.

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